

Message Text

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ACTION TRSE-00

INFO OCT-01 EA-07 ISO-00 CIAE-00 PM-04 H-01 INR-07 L-03
NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 USIA-06
AID-05 COME-00 EB-07 FRB-03 XMB-02 OPIC-03 CIEP-01
LAB-04 SIL-01 OMB-01 STR-04 CEA-01 NEA-10 IO-13
AGRE-00 /108 W

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P 140700Z DEC 76
FM AMEMBASSY MANILA
TO SECSTATE WASHDC PRIORITY 3894
INFO AMEMBASSY SEOUL PRIORITY

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USADB

FOR NAC AGENCIES

E.O. 11652: ADS, DECALS 3/14/77
TAGS: EAID, EFIN
SUBJECT: PROPOSED FOURTH ADB LOAN TO MEDIUM INDUSTRY BANK (KOREA)

SUMMARY: ADB MANAGEMENT PROPOSES \$30.0 MILLION EQUIVALENT
LOAN FROM ORDINARY CAPITAL RESOURCES TO MEDIUM INDUSTRY
BANK (MIB), REPUBLIC OF KOREA (ROK), TO AUGMENT FOREX
RESOURCES TO MIB TO HELP MEET MEDIUM AND LONG-TERM CREDIT
REQUIREMENTS OF SMALL AND MEDIUM INDUSTRIES IN PRIVATE
SECTOR OF KOREA DURING 1977 AND 1978. USADB RECOMMENDS
FAVORABLE NAC ACTION. END SUMMARY.

1. ADB DOC R130-76 WITH ATTACHMENTS DESCRIBING PROPOSED
LOAN POUCHED ADDRESSEES DECEMBER 3. BOARD
CONSIDERATION SCHEDULED DECEMBER 23.

2. ADB MANAGEMENT PROPOSING \$30.0 MILLION LOAN FROM
ORDINARY CAPITAL RESOURCES TO MIB TO MEET PART OF FOREX
REQUIREMENTS FOR ASSISTING SMALL AND MEDIUM ENTERPRISES
IN KOREA IN 1977 AND 1978. ADB HAS MADE THREE PREVIOUS
LOANS TO MIB IN 1969, 1971 AND 1973 TOTALING \$55 MILLION.
FIRST TWO LOANS HAVE BEEN FULLY UTILIZED AND OUTSTANDING

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BALANCE UNDER THIRD LOAN IS EXPECTED TO BE FULLY COMMITTED

BY MID-DECEMBER 1976. PROPOSED TERMS ARE 15 YEAR AMORTIZATION INCLUDING 3 YEAR GRACE PERIOD, 8.9 PERCENT INTEREST. INTEREST RATE TO BE CHARGED BY BORROWER ON SUB-LOANS FROM PROCEEDS OF BANK LOAN WILL BE MAINTAINED AT LEVEL TO PROVIDE BORROWER WITH MINIMUM SPREAD OF 2 PERCENT PER ANNUM. MIB TO BE BORROWER AND ROK THE GUARANTOR.

3. IN LAST FIVE YEARS, ROK ECONOMY HAS RECORDED ANNUAL COMPOUND GROWTH RATE OF 9.8 PERCENT. MANUFACTURING SECTOR, WHICH INCLUDES BULK OF SMALL AND MEDIUM INDUSTRIES, ACCOUNTED FOR HIGHEST CONTRIBUTION TO GNP, WITH 32.1 PERCENT IN 1975. IT HAS DISLOGED AGRICULTURE AS LARGEST SECTOR IN ECONOMY SINCE 1973 WITH 18.8 PERCENT PER ANNUM GROWTH RATE IN REAL TERMS OVER PAST FIVE YEARS.

4. WHILE TOTAL EXPORTS IN NOMINAL TERMS GREW AT ANNUAL COMPOUND RATE OF 40.2 PERCENT BETWEEN 1963 AND 1975, EXPORTS OF MANUFACTURED PRODUCTS INCREASED AT 47.6 PERCENT RATE, ACCOUNTING FOR 89.0 PERCENT OF TOTAL EXPORTS IN 1975. EXPORTS FROM SMALL AND MEDIUM INDUSTRIES IN 1975 ACCOUNTED FOR 37.4 PERCENT OF TOTAL EXPORTS AND 42.0 PERCENT OF EXPORTS OF MANUFACTURERS.

5. TOTAL EMPLOYMENT IN MANUFACTURING SECTOR IN 1974 WAS DOUBLE THAT OF 1967. TOTAL EMPLOYMENT IN SMALL AND MEDIUM INDUSTRIES INCREASED BY 26.4 PERCENT OVER SAME PERIOD. HOWEVER, THEIR SHARE OF TOTAL EMPLOYMENT IN THIS SECTOR DECREASED FROM 58.9 PERCENT IN 1967 TO 37.2 PERCENT IN 1974, REFLECTING RAPID EXPANSION OF LARGE-SCALE INDUSTRIAL OPERATIONS AND GRADUAL SHIFT FROM LIGHT TOWARDS HEAVY AND CHEMICAL INDUSTRIES. DURING THIS PERIOD, THREE LARGEST SUB-SECTORS OF SMALL AND MEDIUM INDUSTRIES SECTOR IN TERMS OF EMPLOYMENT, OUTPUT, AND VALUE ADDED HAS REMAINED: TEXTILE, WEARING APPAREL AND LEATHER; MACHINERY AND EQUIPMENT; FOOD AND BEVERAGES.

6. IN MANUFACTURING SECTOR, ROK'S FOURTH DEVELOPMENT PLAN (1977-1981) AIMS AT IMPROVING INDUSTRY LINKAGES BY ENCOURAGING HORIZONTAL AND VERTICAL INTEGRATION OF SMALL INDUSTRIES TO ACHIEVE SPECIALIZATION AND LIMITED OFFICIAL USE

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ECONOMY OF SCALE, CONTINUOUSLY DEVELOPING HEAVY AND CHEMICAL INDUSTRIES AS WELL AS LABOR INTENSIVE AND EXPORT-ORIENTED INDUSTRIES, AND INDUCING MORE BALANCED REGIONAL GROWTH. SMALL AND MEDIUM INDUSTRIES ARE EXPECTED TO PLAY KEY ROLE IN BALANCED REGIONAL GROWTH AND ARE SUITED TO SKILLED LABOR-INTENSIVE PRODUCTION WHICH ENABLES KOREA TO REMAIN COMPETITIVE. ALSO, IN VIEW OF THEIR COMPLEMENTARITY TO HEAVY AND CHEMICAL

INDUSTRIES, THEY ARE EXPECTED TO CONTRIBUTE TO REDUCING COUNTRY'S
DEPENDENCE ON IMPORTS AND IN DEEPENING INDUSTRIAL
STRUCTURE OF THE ECONOMY.

7. MIB IS MAIN FINANCIER OF SMALL AND MEDIUM ENTERPRISES
IN KOREA AND IS PRACTICALLY ONLY INSTITUTION TO PROVIDE
THEM WITH FOREIGN CURRENCY LOANS. IT WAS ESTABLISHED
IN 1961 AS SPECIALIZED BANK TO PROVIDE ASSISTANCE TO
SUCH ENTERPRISES IN PRIVATE SECTOR. AS OF JUNE 30, 1976.
MIB HAD PAID-IN CAPITAL OF W8.1 BILLION (INCLUDING W5.0
BILLION PAID-IN IN 1976) OF WHICH 99.8 PERCENT IS HELD
BY GOVERNMENT AND 0.2 PERCENT BY A FEW THOUSAND SMALL
PRIVATE SHAREHOLDERS. AN ADDITIONAL W5.0 BILLION IS
UNDER CONSIDERATION BY NATIONAL ASSEMBLY AND IS EXPECTED
IN EARLY 1977. MIB'S AUTHORIZED CAPITAL WAS ALSO RAISED
FROM W6.0 BILLION TO W30.0 BILLION (ABOUT \$60.0 MILLION
EQUIVALENT). MINISTRY OF FINANCE EXERCISES CLOSE
SUPERVISION OVER MIB, DETERMINES ITS POLICY, CONTROLS
ITS OVERALL OPERATIONS AND APPOINTS ITS MANAGEMENT AND
SENIOR STAFF. IN ADDITION TO GOVERNMENT'S FINANCIAL
SUPPORT IS ITS UNCONDITIONAL GUARANTEE TO ABSORB ANY
LOSSES WHICH WOULD OTHERWISE REDUCE MIB'S PAID-IN
CAPITAL. MIB IS NOW AUTHORIZED TO BORROW FROM OTHER
FINANCIAL INSTITUTIONS IN KOREA IN ADDITION TO OBTAINING
FUNDS FROM GOVERNMENT AND BANK OF KOREA.

8. THERE HAVE BEEN FREQUENT CHANGES IN PRESIDENT AND
FREQUENT ROTATION IN BOARD OF DIRECTORS, WHICH HAS BEEN

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FM AMEMBASSY MANILA

TO SECSTATE WASHDC PRIORITY 3895

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FOR NAC AGENCIES

OF CONCERN TO BANK IN VIEW POSSIBLE ADVERSE EFFECTS IN LONG RUN ON EFFICIENCY OF TOP MANAGEMENT. MIB HAS ASSURED BANK THAT APPROPRIATE STEPS WILL BE TAKEN TO ENSURE STABILITY AND CONTINUITY OF MANAGEMENT AND SUPERVISION IN MAIN DEPARTMENTS OF MIB (SIDE LETTER NO. 2, PARA. 10).

9. IN ITS FOREIGN CURRENCY LENDING, MIB IS SUBSTANTIALLY INVOLVED IN LENDING TO SMALLER ENTERPRISES, WITH ABOUT ONE-THIRD OF ITS LOANS GOING TO ENTERPRISES EMPLOYING LESS THAN 50 REGULAR WORKERS DURING 1973-1976. HOWEVER, MORE THAN 86 PERCENT OF THESE LOANS WERE CONCENTRATED IN SEOUL-INCHEON AND BUSAN CITY AREAS AND NORTH GYEONG-ANG PROVINCE WHICH CONTAINS INDUSTRIAL CENTERS OF POHANG AND DAEGU AND GUMI INDUSTRIAL ESTATE. UNDER ITS DEVELOPMENT STRATEGY FOR 1976-1977, MIB INTENDS TO INCREASE FINANCING TO AREAS OUTSIDE METROPOLITAN AREAS IN EFFORT TO DISPERSE GEOGRAPHICALLY ITS PORTFOLIO. IT ALSO INTENDS TO INTENSIFY EFFORTS TO ASSIST SMALL RURAL INDUSTRIES UNDER SAEMAUL PROGRAM AND ITS WORK IN FIELD OF SECTOR, FEASIBILITY AND MARKET STUDIES FOR SELECTED SUB-SECTORS OF SMALL INDUSTRY.

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10. UNTIL 1975, MIB DID NOT MAINTAIN SEPARATE PROVISIONS FOR BAD AND DOUBTFUL DEBTS. HOWEVER, CURRENT PROVISION IS INADEQUATE AND NEEDS TO BE AUGMENTED TO MEET POTENTIAL BAD DEBTS WITHOUT HAVING TO REDUCE NET WORTH. HEREAFTER, MIB WILL SET ASIDE ADEQUATE PROVISION FOR BAD DEBTS REGULARLY AS MAY BE REQUIRED BY EXTERNAL AUDITOR. (IN 1975 GOVERNMENT AMENDED MIB'S ACT WITH EFFECT OF FULLY PROTECTING MIB'S PAID-IN CAPITAL FROM POSSIBLE LOSSES.) MIB'S PROFITABILITY DURING PAST TWO AND A HALF YEARS HAS BEEN ON LOW SIDE, MAINLY DUE TO GOVERNMENT'S POLICY ON INTEREST WHICH IN PART AIMS AT PROVIDING RELATIVELY CHEAP MONEY TO INVESTORS. MIB HAS BEEN LIVING ON INTEREST SPREAD ON LOCAL FUNDS, WHICH WAS LARGELY USED UP TO COVER HANDLING COSTS OF SUCH FUNDS. MIB'S PROFITABILITY IS EXPECTED TO IMPROVE AS RESULT OF INCREASE IN INTEREST RATE IN AUGUST 1976 AND ADDITIONAL CAPITAL ALREADY PROVIDED AND EXPECTED TO BE PROVIDED BY GOVERNMENT. QUALITY OF BANK SUB-LOANS IS VERY GOOD AND GENERALLY

BETTER THAN MIB'S OVERALL LOAN PORTFOLIO. AS OF SEPTEMBER 30, 1976, ONLY THREE SUB-LOANS HAD OVERDUES, AND THESE WERE OF SMALL AMOUNT..

11. AS OF JUNE 30, 1976, MIB HAD ABOUT \$22.6 MILLION IN UNALLOCATED FOREIGN CURRENCY RESOURCES CONSISTING OF \$3.5 MILLION FROM THIRD BANK LOAN AND \$19.1 MILLION FROM ITS FIRST LOAN OBTAINED FROM IBRD IN 1975. (OTHER FOREIGN CREDIT LINES OBTAINED IN PART INCLUDE SEVEN FOR \$56.86 MILLION FROM KFW (GERMANY), OECF (JAPAN), EXIMBANK (JAPAN) AND USAID WHICH HAVE BEEN FULLY UTILIZED.) RECENTLY, GOVERNMENT ALLOCATED \$6 MILLION TO MIB OUT OF ITS OWN FOREIGN BORROWINGS . MOST OF MIB'S AVAILABLE FOREIGN CURRENCY RESOURCES HAVE BEEN COMMITTED. BALANCE IS EXPECTED TO BE UTILIZED BY MARCH 1977 WHEN PROPOSED BANK LOAN IS LIKELY TO BECOME EFFECTIVE. MIB PLANS TO MEET ITS REQUIREMENTS IN 1977 AND PART OF 1978 FROM BANK'S CREDIT LINE. IT ALSO PALNS TO APPROACH IBRD FOR ANOTHER LOAN AT END OF 1977. IN ADDITION, POSSIBILITY OF MIB'S BORROWING FROM INTERNATIONAL CAPITAL MARKET IS BEING ACTIVELY EXPLORED. INDICATIONS ARE THAT INTER-LIMITED OFFICIAL USE

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NATIONAL LENDERS MAY BECOME INTERESTED TO MAKE FUNDS AVAILABLE TO MIB IN FORM OF CO-FINANCING WITH ADB AND ON BASIS THAT BANK IS PREPARED TO PROVIDE FOR CROSS DEFAULT CLAUSE IN CONNECTION WITH ITS PROPOSED FOURTH LOAN TO MIB.

12. FIRST THREEE BANK LOANS HAVE BEEN UTILIZED MAINLY TO FINANCE EXISTING MANUFACTURING FACILITIES IN TEXTILE AND METAL PRODUCTS, MACHINERY AND EQUIPMENT SUB-SECTORS, CONCENTRATED AROUND SEOUL-INCHEON, BUSAN AND DAEGU CITY AREAS. PROPOSED FOURTH LOAN WILL BE CHanneLED INTO MACHINERY AND EQUIPMENT INDUSTRIES INCLUDING METAL PRODUCTS AND INTO TEXTILE, CHEMICALS AND OTHER MANUFACTURING INDUSTRIES. HOWEVER, NOT MORE THAN 35 PERCENT OF LOAN WILL BE USED TO FINANCE TEXTILE INDUSTRY, AND NOT LESS THAN 40 PERCENT OF LOAN WILL BE USED TO FINANCE SUB-PROJECTS IN LESS DEVELOPED AREAS OF COUNTRY.

13. BANK HAS AGREED TO INCREASE FREE LIMIT OF SUB-LOANS FROM PREVIOUS \$300,000 TO \$500,000, BUT FIRST 15 CASE ABOVE \$300,000 WILL BE SUBMITTED FOR BANK'S APPROVAL. MAXIMUM AMOUNT OF EACH SUB-LOAN WILL BE \$1.0 MILLION COMPARED WITH \$600,000 UNDER THIRCD LOAN, PROVIDED APPLICANT WILL STILL QUALIFY AS SMALL OR MEDIUM ENTERPRISE. DEBT/EQUITY RATIO WILL CONTINUE TO HAVE 10:1 CEILING BUT ON SLIGHTLY DIFFERENT DEFINITION. UNDER REVISED FORMULA, AND TAKING ACCOUNT OF

ADDITIONAL W5.0 BILLION CAPITAL INCREASE NOW PENDING
APPROVAL BY NATIONAL ASSEMBLY, DEBT/EQUITY RATIO AS OF
EARLY 1977 WILL BE 8.7:1 AND WELL WITHIN AGREED CEILING.

14. MIB IS GOVERNMENT-OWNED INSTITUTION WITH FULL
SUPPORT, FAITH AND CREDIT OF GOVERNMENT. IT PLAYS A KEY
ROLE IN DEVELOPMENT OF KOREAN ECONOMY THROUGH ITS
ASSISTANCE TO SMALL AND MEDIUM ENTERPRISES. BANK'S MIB-
ASSISTED SUB-LOANS HAVE CONSIDERABLE SOCIO-ECONOMIC
IMPACT BY DIRECTLY GENERATING ADDITIONAL EMPLOYMENT
AND INCREASING EXPORT RECEIPTS. MIB HAS COMMITTED ITSELF
TO POLICY EMPHASIZING GEOGRAPHICAL DIVERSIFICATION IN
FUTURE TO ASSIST LESS DEVELOPED AREAS OF COUNTRY.
AMORTIZATION OF PROPOSED LOAN WILL SUBSTANTIALLY CON-
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FORM TO REPAYMENT SCHEDULE BY SUB-BORROWERS TO MIB
AND WILL BE REPAID WITHIN MAXIMUM OF 15 YEARS INCLUDING
3 YEARS GRACE FROM DATE OF APPROVAL OR AUTHORIZATION
FOR WITHDRAWAL OF SUB-LOAN. USADB SUPPORTS PROPOSAL
AND RECOMMENDS FAVORABLE NAC ACTION.

15. REQUEST SEOUL'S COMMENTS FOR NAC AGENCIES, INFO
USADB MANILA, PURSUANT TO STATE 119795 DATED 3 JULY 1972.
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